



Policy Research Department  
The World Bank  
July 1993  
WPS 1162

# <sup>49</sup> The Slovenian Labor Market in Transition

## Issues and Lessons Learned

Milan Vodopivec  
and  
Samo Hribar-Milic

To stimulate the efficient reallocation of labor, transitional economies should direct resources away from programs to preserve jobs and into programs to create new jobs; allow for flexible determination of relative wages but retain incomes policy; and build support for reform by promoting cooperation among parties involved in collective bargaining.

This paper — a product of the Transition and Macro-Adjustment Division, Policy Research Department — is part of a larger effort in the department to investigate how labor markets work during the transition of socialist economies. It is one of the outputs of the research project "Labor Market Dynamics during the Transition of a Socialist Economy" (RPO 677-20) funded by the Bank's Research Support Budget. This paper was prepared for the 24th National Convention of the American Association for the Advancement of Slavic Studies, held in November 1992 in Phoenix, Arizona. Copies of this paper are available free from the World Bank, 1818 H Street NW, Washington, DC 20433. Please contact Sabah Moussa, room N11-017, extension 39019 (July 1993, 37 pages).

Yugoslavia (including Slovenia) has been more market-oriented than the rest of Eastern Europe, with little or no planning and healthier development of product markets. Until recently, however, the labor market in Slovenia was subject to formidable constraints.

But sweeping legislative changes and a dramatic change in the climate of the Slovenian economy have produced major shifts in the allocation of Slovenia's labor force. Most important, the Rubicon of job security has been crossed: Slovenian workers — who like other Yugoslav workers were more protected from job loss than workers in most socialist countries — can now be laid off. Partly as a result of layoffs and bankruptcies, there has been a dramatic increase in unemployment — from 1.5 percent in the mid-1980s to 12.5 percent in January 1993. Moreover, social sector employment decreased 17.6 percent from December 1989 to December 1991, and the labor force participation rate dropped by nearly 8 percentage points.

Among lessons learned about the labor market in Slovenia's transition to a market economy:

- Governments in transitional economies tend to preserve current jobs through employment subsidies and by subsidizing early retirement. To stimulate the efficient reallocation of labor, they should redirect resources away from programs to preserve jobs into programs to create new jobs.

And to increase the flexibility of adjusting firms' workforces, transitional economies should legislate simple layoff procedures and should not assign firms the responsibility for financing redundant workers.

- It may be easy to demolish the old system of determining wages, but it is difficult to develop a new, well-functioning system. One country cannot simply copy another's methods. It is important to provide for a minimum wage, but it is inefficient to establish a complete wage structure, or to provide for automatic cost-of-living adjustments which hinder wage moderation and make the wage structure inflexible. Moreover, while state and social ownership prevail, an incomes policy is a must.

- The trial and error approach to finding the right mix of active labor market policies is unavoidable. But governments should evaluate the effectiveness of such programs and weigh them against alternative policies aimed at reducing unemployment — notably increased public spending and investment tax credits.

- Unilateral government action is counterproductive. To overcome mutual hostility and achieve cooperation, governments should, among other things, consult with trade unions on the legislation and programs to be introduced, and wage a public relations campaign to demonstrate the unavoidability of reform and to emphasize program successes.

The Policy Research Working Paper Series disseminate the findings of work under way in the Bank. An objective of the series is to get these findings out quickly, even if presentations are less than fully polished. The findings, interpretations, and conclusions in these papers do not necessarily represent official Bank policy.

# **THE SLOVENIAN LABOR MARKET IN TRANSITION: ISSUES AND LESSONS LEARNED**

**Milan Vodopivec**

**The World Bank  
Transition and Macro-Adjustment Division  
Policy Research Department**

**and**

**Samo Hribar-Milic  
Employment Office of Slovenia**

**Paper prepared for the 24th National Convention of the American Association for the Advancement of Slavic Studies, held in Phoenix, AZ, November 19-22, 1992. Valuable comments of Branko Milanovic and Kenneth Zapp are gratefully acknowledged.**

The Slovenian Labor Market in Transition:  
Issues and Lessons Learned

Table of Contents

1. FEATURES OF THE SLOVENIAN LABOR MARKET . . . . .	3
2. RECENT SHIFTS IN LABOR ALLOCATION . . . . .	11
3. RECENT INSTITUTIONAL CHANGES . . . . .	12
4. PROBLEMS PLAGUING THE LABOR MARKET . . . . .	25
1. Inconsistent, Overrestrictive Redundancy Policy . .	25
2. Lack of Incomes Policy . . . . .	27
3. Inefficient Collective Bargaining . . . . .	28
4. Overgenerous Benefits . . . . .	30
5. Lack of Coherent Active Labor Market Policies . . .	31
5. LESSONS LEARNED . . . . .	32
<u>REFERENCES</u> . . . . .	36

TABLES

Table 1: Slovenian Labor Force, 1981-1991 . . . . .	4
Table 2: Comparison of Labor Force Participation Rates, 1989 . . . . .	5
Table 3: Level of Education in the Labor Force . . . . .	6
Table 4: The Relative Composition of Employment, 1989 . .	7
Table 5: Relative Rates of Migration . . . . .	8
Table 6: Labor Turnover, 1975-89 . . . . .	9

The formerly socialist economies of Eastern Europe and the Soviet Union are beginning to fundamentally restructure their economic and political systems, with the clear goals of becoming market economies and multiparty democracies. Reform of the labor market -- which in these economies were gravely rigid -- is essential to these efforts.

Yugoslavia's self-management system has often been regarded as a third way, a system fundamentally different from those in other socialist economies. But the difference has been exaggerated. In fact, the Slovenian labor market has shared the key features of the labor market in other socialist economies: heavy social sector employment; full employment together with substantial hidden unemployment; heavy female participation in the labor force; a relatively well-educated labor force; heavy employment in industry; little geographical mobility; an egalitarian wage structure; over-generous fringe benefits; and government and worker involvement in wage determination. Fundamental reform of the labor market is as essential in Slovenia as in all of the formerly socialist economies.

It is also true that Slovenia is atypical in certain respects. First, Yugoslavia -- including Slovenia -- was historically more market-oriented than the rest of Eastern Europe. The absence of not only central, but virtually any planning -- a striking difference from other Eastern European economies -- influenced the working of Yugoslav product markets and contributed to the emergence of both tangible infrastructure (such as communications, financial, and banking systems and

marketing units in firms) and intangible infrastructure (producers' networks).<sup>1</sup> Second, Slovenia is wealthier than most other regions of Eastern Europe, so there is reason to suspect that making the transition to a market economy there may be less wrenching than elsewhere in Eastern Europe. Even should this be true, however, analyzing the problems encountered in this "best case" situation should be illuminating.

In this paper, we describe the transition of the Slovenian labor market to date, and draw lessons relevant for other economies undergoing transition. As part of comprehensive economic reform, the Slovenian labor market has in the last three years undergone major transformations. Above all, the Rubicon of job security has been crossed: Slovenian workers -- who were, together with other Yugoslav workers, more protected from job loss than workers in most socialist countries -- can now be laid off.<sup>2</sup> Labor mobility is facilitated by more flexible hiring legislation, and collective bargaining has replaced the rigid system of wage determination that prevailed under self-management. But numerous shortcomings remain: redundancy legislation is inconsistent and still overrestrictive; the major institutional players in collective bargaining neither trust each other nor cooperate; cash and fringe benefits remain too

---

<sup>1/</sup> But factor markets were exempted from this "marketization." Until recently, there were formidable constraints on the working of the labor market and capital allocation was controlled mainly by politicians (see Prasnikar and Svejnar 1988).

<sup>2/</sup> Unlike constitutions in other transitional economies, Yugoslavia's constitution forbade layoffs. Yugoslavia amended its constitution in 1988 to allow for layoffs.

generous; there is no incomes policy nor are there coherent active labor market policies.

After characterizing the Slovenian labor market, and recent shifts in market reallocation, we describe recent institutional reforms, analyze current problems, and conclude with lessons learned.

## 1. FEATURES OF THE SLOVENIAN LABOR MARKET

In most important respects, the Slovenian labor market has closely resembled the labor market in other Eastern Bloc countries. We describe its chief features briefly.

Heavy Social Sector Employment. One profoundly influential feature of socialist economies has been heavy state and social ownership and the dearth of private enterprise. The Yugoslav republics have been somewhat more permissive about private enterprise than other Eastern European countries, but the social sector accounted for almost 85 percent of Slovenian employment in 1988 (table 1). In 1988, agriculture accounted for over half of Slovenian private sector employment, and nonagricultural private sector employment comprised only 6.8 percent of total employment.

Hidden Unemployment. Slovenia has suffered from considerable hidden unemployment,<sup>3</sup> partly because of constitutionally guaranteed job security,<sup>4</sup> and partly because of

---

<sup>3/</sup> Inefficiencies of the so-called full-employment syndrome are discussed in Vodopivec (1991a).

<sup>4/</sup> Based on an empirical analysis of Slovenian firms, Vodopivec (1991b) identifies ~~in~~ firm redistribution of income as the mechanism that allows job security to persist in reforming socialist economies.

TABLE 1: SLOVENIAN LABOR FORCE, 1981-1991  
(end of the year, in thousands)

	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
Social sector employment	780	786	792	803	814	828	838	831	820	751	676
% of women	44.8	45.2	45.4	45.4	45.6	45.9	46.0	46.3	46.5	48.7	47.3
Private agric. employment	108	103	101	96	104	99	98	103	99	98	97
% of women	55.8	55.8	55.2	56.0	53.0	53.0	52.8	52.7	52.3	52.0	51.3
Private non-agric. empl.	49	52	54	57	64	68	67	67	69	70	77
% of women	33.3	33.3	33.3	33.3	33.3	33.3	33.3	33.3	33.3	33.3	33.2
Unemployment	12.0	14.0	16.0	15.0	15.0	14.0	18.0	25.4	33.8	55.4	91.2
% of women	57.1	56.8	55.3	54.3	53.7	51.1	48.8	47.3	48.9	47.9	44.7
Labor force -- total	949	955	963	971	997	1009	1021	1026	1022	974	941
% of women	45.6	45.9	45.9	45.9	45.7	45.8	45.9	46.1	46.2	47.9	46.3

Memorandum items:

Unemployment rate (Slovenia)	1.3	1.5	1.7	1.5	1.5	1.4	1.8	2.5	3.3	5.7	9.7
Unempl. rate--Yugoslavia	8.6	9.0	9.4	9.9	10.4	10.7	10.5	11.0	11.6	12.8	---
Labor force part. rate	78.1	78.0	78.1	78.4	80.1	80.8	82.0	81.5	80.9	76.8	73.1
Women	71.8	72.0	72.2	72.4	73.9	74.6	75.8	75.7	75.4	74.1	68.2
Men	84.3	83.8	83.9	84.2	86.3	86.9	88.1	87.2	86.4	79.5	77.9
Labor force growth	---	0.6	0.8	0.8	2.7	1.2	1.2	0.5	-0.4	-4.6	-3.4
Number of retirees	276	284	293	304	316	327	340	357	375	397	423
Ratio employees/retirees	3.4	3.3	3.2	3.1	3.1	3.0	2.9	2.8	2.6	2.3	2.0
Working age population	1215	1225	1233	1239	1244	1249	1245	1259	1263	1269	1288

Sources: Statistical Yearbook of Slovenia, various issues; Statistical Yearbook of Yugoslavia, various issues; Statistical Office of Slovenia, and Yearbook on Social Protection in Slovenia, 1991.

Notes: Participation rate is defined as the labor force as a percentage of the working-age population (15-59 for women, 15-64 for men). The 1990 unemployment rate for Yugoslavia is estimated. Women's share in the working-age population, and the share of women in non-agricultural private employment, are estimates of the Statistical Office of Slovenia. The number of retirees at the end of the year was estimated from yearly averages.

political pressures to hire.<sup>5</sup> Mencinger's (1989) estimate of the rate of hidden unemployment (redundant workers as a percentage of total employment) for Slovenia's social sector was 13.5 percent in 1988. Underuse of work time (a proxy for hidden unemployment) in other socialist economies has ranged from 10 to 30 percent (Vodopivec 1991a). As in other socialist economies, but unlike the rest of Yugoslavia, open unemployment was virtually unheard

<sup>5/</sup> Prasnikar and others (1990) provide a fruitful theoretical and empirical investigation of determinants of employment behavior of Yugoslav firms.



of in Slovenia until very recently.<sup>6</sup>

Heavy Female Participation in the Labor Force. The male labor force participation rate in Slovenia has been comparable to that in most OECD countries, but the female participation rate has been much higher (table 2). Slovenia shares this high female

TABLE 2: COMPARISON OF LABOR FORCE PARTICIPATION RATES, 1989  
(percentages)

	Total	Women	Men
Slovenia	79.4	74.4	84.4
Socialist economies			
Yugoslavia	64.5	55.6	73.3
Czechoslovakia	87.3	84.6	89.8
Poland	80.2	77.2	82.9
Romania	84.2	80.6	87.3
Soviet Union	78.0	72.0	84.0
Selected OECD countries			
Austria	67.2	54.3	80.4
France	65.6	55.7	75.4
Germany	68.2	54.5	82.8
Greece	59.8	43.4	75.6
Italy	60.7	44.0	77.8
Japan	73.4	59.3	87.2
Spain	58.6	39.9	77.4
Sweden	83.3	81.0	85.6
United Kingdom	76.0	65.2	86.8
United States	76.8	67.9	85.9

Sources: Table 1; OECD Employment Outlook, OECD, Paris, July 1990; IMF, IBRD, OECD, and EBRD, The Economy of USSR, 1990; Statistical Yearbook of Czechoslovakia, 1990; Statistical Yearbook of Poland, 1990; World Bank, Romania: Accelerating the Transition: Human Resource Strategies for the 1990s (Report No. 9577-RO), May 1991.

Notes: Participation rate is defined as the labor force as a percentage of the working-age population. The working-age population is 15-64; except for Yugoslavia and Slovenia (15-59 for women, 15-64 for men); Czechoslovakia (15-55 for women, 15-60 men); Poland (18-59 women, 18-64 men); and Romania (16-55 for women, 16-59 for men). Because of differences in the definition of working-age population, participation rates for socialist countries tend to be biased upward. For France, Germany, and Greece, women's and men's participation rates are for 1988.

---

<sup>6/</sup> Unlike other socialist countries, Yugoslavia has allowed for the existence of open employment since the 1950s, but kept it low until the early 1970s. Unemployment rose during the stagnant years of the 1980s, and reached a historical peak of 12.8 percent in 1990 (see table 1).

participation rate with other socialist countries. (The overall participation rate has been significantly higher in Slovenia than in the rest of Yugoslavia, but similar to that in other Eastern European countries.)

Relatively Well-Educated Labor Force. The Slovenian labor force, like those in other Eastern European economies, is better educated than labor forces in the developing world or the Southern European countries (table 3). The Slovenian labor force averages 9.3 years of education, which is slightly less than the average for socialist economies (9.5 years) and not far below the average for the developed market economies (10 years).

TABLE 3: LEVEL OF EDUCATION IN THE LABOR FORCE

	Percentage of the labor force with				Mean years of schooling
	No education	Primary education (completed or uncompleted)	Secondary education (completed or uncompleted)	Higher education	
Slovenia (1988)	0.0	32.6	61.8	5.6	9.3
Socialist countries-(average)	2.2	39.4	52.4	5.9	9.5
Yugoslavia (1981)	7.1	52.5	35.9	4.2	5.6
Bulgaria (1975)	4.0	67.6	22.5	5.9	8.7
Czechoslovakia (1980)	0.0	37.5	55.7	6.8	11.5
Hungary (1980)	0.7	28.2	62.7	8.4	10.4
Poland (1978)	1.3	8.6	84.7	5.4	10.7
Romania (1977)	0.0	42.1	53.0	4.9	9.8
Developed market countries	0.4	27.1	56.1	16.3	10.0
Southern European countries	12.5	59.1	20.6	7.8	5.9
Middle East and North Africa	50.2	29.8	15.9	3.6	3.4
East Asia and the Pacific	16.1	45.0	33.0	5.8	6.4

Sources: Statistical Yearbook of Slovenia (own calculation for the mean years of schooling in Slovenia); G. Psacharopoulos and A.M. Arriagada, *The Educational Composition of Labor Force: An International Comparison*, *International Labour Review*, Vol. 125, No.5, 1986.

Notes: The data refer to formal education. Developed market economies are: Austria, Belgium, Canada, Denmark, Finland, France, West Germany, Japan, Netherlands, New Zealand, Norway, Switzerland, and United States (data from 1975-82). Southern European countries are Greece, Portugal, Spain, and Turkey (data from 1980-81). Middle East and North Africa countries are Afghanistan, Algeria, Bahrain, Egypt, Iran, Jordan, Kuwait, Lebanon, Morocco, Qatar, Syria, Tunisia, United Arab Emirates, and Yemen (data from 1970-81). East Asia and Pacific countries are China, Taiwan, Fiji, Hong Kong, Indonesia, Korea, Malaysia, New Caledonia, Philippines, Singapore, Thailand, and Tonga (data from 1976-83).

Concentration of Jobs in Industry. As in other Eastern European economies, Slovenian jobs are heavily concentrated in industry. In 1989, over 44 percent of workers were employed in industry, 10.9 percent in agriculture, and 45 percent in services (table 4). High-income OECD countries have much larger service sectors than the Eastern European countries do. Slovenia's underdeveloped services thus offer ample opportunities for

TABLE 4: THE RELATIVE COMPOSITION OF EMPLOYMENT, 1989  
(Percentage)

	Agriculture	Industry	Services
Slovenia	10.9	44.1	45.0
Socialist countries			
East Germany	10.3	45.4	44.4
Czechoslovakia	11.7	47.1	41.1
Bulgaria	19.3	46.3	34.4
Soviet Union	20.2	35.2	44.6
Hungary	21.1	38.6	40.3
Yugoslavia	25.0	36.0	39.0
Poland	29.9	39.7	30.4
Selected OECD countries			
Austria	8.0	37.0	55.1
France	6.4	30.1	63.5
Germany	3.7	39.8	56.5
Italy	9.3	32.4	58.2
Spain	13.0	32.9	54.0
Portugal	19.0	35.3	45.7
Sweden	3.6	29.5	67.0
United Kingdom	2.1	29.4	68.4
United States	2.9	26.7	70.5

Sources: Table 1; Statistical Yearbook of Yugoslavia, various issues; OECD, Quarterly Labour Force Statistics, NO.4, 1990; IMF, IBRD, OECD, EBRD, The Economy of USSR, 1990; L. Riveros, Wage and Employment Policies in Czechoslovakia, PRHEE, World Bank, 1991, processed; C. Burda, Labor and Product Markets in Czechoslovakia and the Ex-GDR: A Twin Study, INSEAD, 1991, processed; L. Fox, Labor Markets in Bulgaria: Policies, Institutions, and Results. EM4HR, World Bank, 1991, processed; World Bank, Poland: Employment Promotion and Services for a Market Economy, 1990.

Notes: Agriculture comprises ISIC Major division 1: agriculture, hunting, forestry, and fishing; Industry comprises ISIC Major divisions 2-5: mining and quarrying; manufacturing; electricity, gas and water; and construction. Services comprise ISIC Major divisions 6-9 plus 0: wholesale and retail trade, restaurants and hotels; transport, storage and communications; financing, insurance, real estate and business services; community, social and personal services; and activities not adequately defined. Data for Soviet Union and Bulgaria refer to 1988; for Hungary, to 1985.

expansion, which has already begun. By 1990, services had increased their share in value-added by 9 percentage points over 1987 (Ministry of Planning 1992).

Low Mobility. Geographically, workers in Slovenia and other Eastern European countries are much less mobile than workers in the OECD countries (table 5). The lack of a functioning housing market in these economies has been a major impediment to

TABLE 5: RELATIVE RATES OF MIGRATION  
(people who migrated as a percentage of total population)

	Interregional migration (a)	Total migration (b)
Slovenia (1989)	0.24	2.2
Yugoslavia (1989)	0.25	1.4
Hungary (1989)	---	1.9
Poland (1989)	---	1.6
OECD countries (1987)		
France	1.3	---
Germany	1.1	---
Italy	0.5	---
Japan	2.6	---
Sweden	3.9	---
United Kingdom (1986)	1.1	---
United States	2.8	---

Sources: Statistical Yearbook of Slovenia, 1990; Federal Statistical Office of Yugoslavia; Statistical Yearbook of Hungary, 1989; Poland: Employment Promotion and Services Project (Report No. 9408-POL), May 1991, World Bank; OECD Employment Outlook, OECD, Paris, July 1990.

Notes:

- (a) Regions in Yugoslavia are republics and autonomous provinces; definitions in other countries vary (in Germany, for example, cities may be called regions).
- (b) Total migration is defined as any change of permanent residence (within the country).

geographic mobility (Renaud 1990).<sup>7</sup> Furthermore, the labor turnover (job-changing) rate in Slovenia is lower than in most OECD countries, although it is also (for somewhat different reasons) lower than in the other Eastern European economies (see table 6).

TABLE 6: LABOR TURNOVER, 1975-89  
(Annual number of separations per 100 employees)

	1975	1980	1985	1989
Slovenia	16.3	16.2	13.7	12.2
Socialist countries				
Yugoslavia	14.6	14.3	12.6	11.3
Poland	21.7	18.3	17.9	19.8
Hungary	---	---	---	24.4
Czechoslovakia	---	---	17.9	19.6
Bulgaria	---	---	---	21.0
Soviet Union (a)	---	---	---	21.2
OECD countries				
France	---	17	18 (b)	---
Germany	25	30	---	---
Italy (a)	14	15	---	---
Japan	16	14	14 (b)	---
Sweden (a)	21	20	17 (b)	---
U.K. (a)	30	25	21 (b)	---
U.S. (a)	50	48	---	---

Sources: Statistical Yearbook of Yugoslavia; Statistical Yearbook of Czechoslovakia; Statistical Yearbook of Poland; Statistical Yearbook of Hungary; World Bank, Bulgaria: Crises and Transition to a Market Economy (Report No. 9046-BU, 1991 L), 1991; IMF, World Bank, OECD, EBRD, A Study of the Soviet Economy, 1991; OECD, Flexibility in the Labor Market (The Current Debate), 1986.

Notes: (a) Manufacturing only  
(b) 1984

---

<sup>7/</sup> According to Rus (1992), however, about 10 percent of Slovenian workers -- relatively skilled workers -- have emigrated to the West in the last three decades.

Egalitarian Wage Structure. As in other Eastern European economies, ideological forces have led to a compression of the wage structure in Slovenia. Prasnikar and Svejnar (1988, p. 279), for example, note that the pay differential between skilled Yugoslav workers and managers, on the one hand, and unskilled workers, on the other, is smaller than in capitalist firms. This tendency was reinforced by worker participation in decision-making about pay.<sup>8</sup>

Generous Fringe Benefits. Like other Eastern European workers, Slovenian workers are entitled to generous nonwage benefits. Some benefits -- such as health care, pension plan, paid vacations, and paid sick and maternity leave -- are also common in the West. But some benefits -- especially paid sick and maternity leave -- are far more generous than in the typical market economy. Also, Slovenian workers, like workers elsewhere in Eastern Europe, are eligible for a variety of employer-provided benefits (such as free meals, transportation to and from work, and subsidized housing) that are rare in the West.

Government Involvement in Wage Determination. Because of ill-defined property rights in the socialist economies, the interests of owners (employers) are poorly represented in collective bargaining. To countervail workers' calls for wage

---

<sup>8/</sup> For a description and evaluation of the effects of worker participation in pay decisions, see Vodopivec (1992a).

increases, the government is called in.<sup>9</sup> (Until recently, Slovenian incomes policy tied the growth of the wage bill to growth in the cost of living -- see below.)

## 2. RECENT SHIFTS IN LABOR ALLOCATION

Sweeping legislative changes (see below) and a dramatic change in the climate of the Slovenian economy -- of which the best indicators are the emergence of opposition parties and the election of the first noncommunist government in the spring of 1990 -- have produced major shifts in labor force allocation (table 1). Most conspicuously, social sector employment decreased 17.6 percent from December 1989 to December 1991, shedding workers primarily to unemployment and retirement (few firms have been privatized, so the shrinking of the social sector should be attributed to attrition, layoffs and bankruptcies). Moreover, private nonagricultural employment grew strongly in 1991. The number of persons in the labor force decreased by a spectacular 4.6 percent in 1990 and 3.4 percent in 1991, and the labor force participation rate dropped by nearly 8 percentage points between December 1989 and December 1991.

The most notable consequence of the shedding of labor from the social sector so far has been a dramatic increase in unemployment. After stable unemployment of 1.5 percent in the mid-1980s and creeping unemployment in 1988 and 1989, unemployment

---

<sup>9/</sup> Government regulation of wages in socialist economies is a long established practice. Its history is summarized, in Vodopivec (1991a).

has exploded since 1990, soaring to 91,000 (9.7 percent) by December 1991, a nearly threefold increase in just two years.<sup>10</sup> Unemployment showed some signs of stabilization in the first half of 1992, but it has been increasing steadily since July 1992, reaching a record high of about 12.5 percent by January 1993 (118,000 registered unemployed).

Plant closures have also become, for the first time, an important source of unemployment. Since the fall of 1989, the number unemployed because of plant closures has increased rapidly, reaching 20,000 in December 1991.

### 3. RECENT INSTITUTIONAL CHANGES

Reform legislation enacted in 1988/89 still under the old Yugoslavia (above all, the Enterprise Law and the Labor Code) provides the basis for restructuring the labor market. The most important new labor market policies involve employment, redundancy, and unemployment insurance legislation, wage-setting policies, and active labor market policies (described below). Many measures adopted in Slovenia are strikingly similar to measures that have been adopted in other former socialist countries undergoing transition to a market economy.

- Employment Legislation. The Labor Code has introduced many important changes. Hiring has been freed from external constraints, and the procedures for hiring have been simplified.

---

<sup>10/</sup> But, according to a labor market survey, 42.5 percent of the unemployed performed some paid work in 1990 (Svetlik 1992).



Reassignment of workers within a firm has become more flexible, and it is now possible for a worker to be temporarily assigned to another firm. Legal possibilities for part-time work and fixed-term employment have been broadened. And the March 1992 pension law calls for a gradual increase in the normal pensionable age from 60 to 63 for men, and from 55 to 58 for women (the ages are 65 for men, and 60 for women, for workers with insufficient working years). This last will reduce the fiscal burden of pensions.

- Redundancy Legislation. Current legislation governing layoffs (or "technological redundancies," as they are called) represents one of the most radical breaks with the past to date. It emerged in two steps:

October 1989 - February 1991. The Yugoslav labor code of October 1989 gave employers the right to lay off workers, but made layoffs very costly. A firm could lay off a worker only after providing him or her with one of the following (Art. 21 of the federal labor code; the Slovenian labor code of April 1991 simply adopted the federal provisions):

- a) Placement in another firm;
- b) Retraining or upgrading for a position in the same or in another firm (in training, the worker received a personal income of no less than minimum wage);
- c) The purchase of pension credits, if within five years of retirement;

- d) Severance pay amounting to at least 24 months of the worker's personal earnings (average monthly earnings in the last quarter), contingent upon the resources being used either to finance the creation of a small business or to obtain employment in a firm through the purchase of its shares;
- e) Compensation of at least the minimum wage payable for not more than 24 months, if none of the above options was implemented. (This option has been referred to as "paid vacation," since workers receiving such compensation have typically not worked.)

The responsibility for financing the options of redundant workers was left to the firm, but the Labor Code allowed for external financial assistance. In 1990, Slovenian firms were reimbursed about 50 percent of the costs incurred in financing these options (from both federal and republic funds).<sup>11</sup>

February 1991 to Present. Further changes were introduced by the amendments to the Slovenian labor code passed in February 1991. The most significant innovation associated with this law was a reduction in the benefits to which "technologically redundant" workers are entitled. Most notably,

---

<sup>11/</sup> In 1990, the Slovenian government cofinanced 21,223 redundant workers. Of these, 172 were trained and placed in another firm; 1,082 chose early retirement; 2,499 received a lump-sum payment; and 17,470 were on "paid vacation."

the amendments call for reducing the period of advance notification about the layoff from 24 to 6 months. Redundant workers now have the following options:

- a) Reassignment within a firm (including to a job that requires fewer skills, with the worker's consent);
- b) Retraining or skill upgrading (to last for up to 6 months);
- c) Purchase of pension credits, if within 5 years of retirement;
- d) Compensation of at least the minimum wage payable for not more than 6 months.

Upon termination of employment, redundant workers are also entitled to severance pay of one month's earnings for each year of employment with the current employer.

In the case of mass layoffs, firms have to prepare restructuring programs that include, among other things, the identification of redundant workers together with the options they are taking.<sup>12</sup> Decisions about the restructuring program, including decisions about redundant workers, rest with the worker council (in social enterprises) or with the manager (in private

---

<sup>12/</sup> Mass layoff is defined as a layoff of at least the following number of workers during consecutive 45 days: 10 workers, in a firm with fewer than 100 workers; 10 percent of the workers, in a firm with 100 to 300 workers; and 30 workers, in a firm with more than 300 workers.

enterprises).<sup>13</sup> If the trade union does not agree with the program, it may initiate an arbitration procedure. The arbitration committee (comprising an equal number of representatives of the employer and employees) has the final word. The influence of managers of social enterprises is substantial: they identify redundant workers, and, in the case of non-mass layoffs, also make decisions about the layoff.<sup>14</sup>

A key component of reform in other Eastern European countries has also been to enact redundancy legislation, thus ending the era of virtually complete job security. Poland's labor code, for example, calls for advance notice of up to 90 days when an individual's employment is to be terminated, and an additional 45 days of advance notice to labor unions and employment offices in the event of a mass layoff.

- Unemployment Insurance Benefits. The February 1991 law on unemployment insurance (Official Gazette of the Republic of Slovenia, May 1991), gives unemployed workers the right to:

- a) Unemployment compensation;
- b) Unemployment assistance;

---

<sup>13/</sup> Criteria for identifying redundant workers are spelled out in the general collective bargaining agreement of August 1990. They are (in order of priority): work quality (productivity), qualification, work experience, seniority, health, and social factors (number of dependents, whether it might be possible for the individual to work on a farm or become self-employed, and whether the individual is an owner or part-owner of a mixed or private firm).

<sup>14/</sup> To get rid of the influence of worker councils, many social enterprises transfer their assets and workers, and thus all their operations, to a newly created subsidiary that is considered a private company and thus need not have a worker council. The parent enterprise is transformed into a purely financial institution (see Korze 1991).

- c) Training;
- d) Reimbursement for moving expenses connected with reemployment;
- e) Health and age insurance (for up to a year).

Individuals' eligibility to collect unemployment compensation is affected both by the previous level of earnings and by the duration of their previous employment.<sup>15</sup> For the first three months of unemployment, the benefit equals 70 percent of the worker's monthly average earnings over their last three months of employment; it is 60 percent thereafter. Compensation has both a ceiling (400 percent of the minimum wage) and floor (80 percent of the minimum wage).

Workers may collect capitalized unemployment compensation as a lump-sum payment, provided they use the resources to find gainful employment (either permanent employment or self-employment). There were 3,468 such cases in 1991. The majority found employment by investing in (social, private, or mixed) enterprises; about 16 percent started their own business.

After their right to unemployment compensation expires, unemployed workers are eligible for income-tested unemployment assistance. The same amount is paid to all unemployment assistance recipients (80 percent of the minimum wage) and the benefit

---

<sup>15/</sup> Unemployment compensation lasts 3 months for at least 9 months of uninterrupted employment, or for at least 12 months of employment in the last 18 months; 6 months for at least 30 months of uninterrupted employment, or for at least 50 months in the last 5 years; 9 months for employment above 5 years, but less than 10 years; 12 months for employment above 10 years, but less than 15 years; 18 months for employment above 15 years, but less than 20 years; and 24 months for employment above 20 years.

is payable for up to three years from the date the individual first receives unemployment compensation.

Coinciding with the passage of laws permitting the dismissal of workers, other Eastern European countries have also instituted unemployment insurance schemes. Like Slovenia, most have chosen to provide earnings-related benefits, with limits on the maximum and minimum amounts payable. Moreover, the share of earnings replaced by unemployment benefits has been made a declining function of the duration of unemployment, and the potential duration of benefits is limited. The unemployed are also entitled to other benefits, such as free training, loans or grants for the development of micro-enterprises, and reimbursement of relocation expenses (Hungary, Poland).

- Wage Setting. The old system of wage setting has recently been dismantled and replaced by a system with three components: the Labor Code, collective bargaining, and incomes policy. (The last component is currently inactive.)

In principle, the Labor Code removes administrative constraints on the wage bill, as well as collective decisionmaking about the wage scale. It authorizes managers to determine wages, thereby significantly simplifying procedures. The law also gives workers the right to a "guaranteed" personal income -- that is, a minimum wage (to be determined either by law or in collective bargaining agreements).<sup>16</sup>

---

<sup>16/</sup> Currently, the law sets the minimum wage at 60 percent of the mean net earnings of the social sector in the previous six months.

The law also introduces collective bargaining -- a genuinely new component -- into the system of wage setting. The law allows for general, industry, and enterprise collective agreements, and specifies, in general terms, the content of the agreements and procedures for settling grievances and disputes.

The first general agreement for Slovenia was ratified in August 1990; 28 more industry agreements have been accepted since then.<sup>17</sup> The general agreement was agreed upon by the Chamber of Economy of Slovenia and the "old," official trade union. This trade union has been increasingly challenged by two emerging general unions (particularly in certain regions), as well as several other craft unions.

The general agreement for Slovenia calls for classifying workers in nine categories, and prescribes the minimum basic wage for each category. The basic wage for the highest category is three times that of the lowest category. The agreement prescribes wage indexation, with incomplete indexation for cost-of-living increases of more than 5 percent a month.

The third component of the wage-setting system, an incomes policy, is not currently active. When the Incomes Policy Law expired in February 1992, there was fierce opposition to its

---

<sup>17/</sup> The agreements also regulate, among other things, the institutions and procedures for selecting new workers; items covered under the individual job contract; the probationary period and internship; internal deployment of workers; procedures and criteria for selecting technologically redundant workers; work hours; night-time work; such fringe benefits as regular and special leave; work safety; education and training benefits; organization and rights of the trade union within the firm; and the settlement of grievances and disputes.

extension.<sup>18</sup> Trade unions, its main opponents, argued that the existence of collective bargaining made separate legal restrictions on the wage bill not only unnecessary, but counterproductive -- because they conflicted with collective agreements. (Not surprisingly, real wages have increased dramatically since then -- see below.)

Similarities between Slovenia and other Eastern European economies extend to wage setting. Collective bargaining has emerged in all other ex-socialist economies, with the same kind of confrontation among unions for worker representation as in Slovenia. All the other Eastern European countries have introduced incomes policies; in Bulgaria, Hungary, and Poland, these have taken the form of so-called tax-based incomes policies. Moreover, minimum wage scales for different categories of labor, like those in Slovenia, have been agreed upon in Bulgaria and Poland.

- Active Labor Market Policies. In addition to traditional training programs, several new programs were introduced in 1991 to provide hiring and employment subsidies, to create temporary public sector jobs for the unemployed, and to provide self-employment.

Training. Programs exist for both the unemployed and

---

<sup>18/</sup> The 1991 incomes policy law contained the growth of socially-owned firms' wage bill by tying the growth of the wage bill to growth in the cost of living. The law called for the less-than-proportional growth of the wage bill, if the cost of living grows faster than 5 percent a month. The law also limited managerial salaries by constraining the wage of the highest-paid individual at the firm to be less than 15 times the minimum wage.



the employed, with separate programs for invalids. Two basic types of training for the unemployed are regular training and internship.

- a) Regular training, open to all the unemployed, takes the form mainly of vocational training (provided by a specialized training institution or by the employer through on-the-job-training). General education is less common. Training has to be approved by the employment office staff; all costs (including transportation and meals) are covered by the employment office.
- b) Internship takes the form of on-the-job-training, under a fixed-term employment contract, of six to twelve months. Eligible are first-time job seekers who have completed a three-year vocational school, high school, or university (the so-called interns -- "pripravniki"). There is a mandatory examination at the end of training.

Since 1988, the government has also cofinanced the training of employed workers. It mostly takes the form of customized training (of 4-5 months), but also includes general education. To be eligible for government financial assistance, firms must prepare restructuring programs, detailing their training needs.

With the increase in unemployment, the number of people in training has increased significantly since 1989, severely straining existing training capacity. There were 9,000

participants in training for the unemployed in 1990 and 17,000 in 1991 (about 70 percent of them as interns), compared with only 4,800 in 1989 (60 percent interns). Similarly, the number of employed workers who underwent training increased from 5,600 in 1988 to 20,000 in 1989, 21,000 in 1990, and 46,500 in 1991.<sup>19</sup>

Compared with other Eastern European economies, Slovenia seems to have relatively well-developed training programs, and proportionally more of its unemployed enroll in training.

Hiring and Employment Subsidies.<sup>20</sup> In response to mounting unemployment, the Ministry of Labor introduced several other programs to help the unemployed. One of them is a lump-sum subsidy (of about \$2,000) to employers who permanently hire an unemployed person. In 1991, 3,300 jobs were created through that subsidy.

Another program, introduced in mid-1991, amounts to employment subsidies to financially distressed firms. To alleviate the consequences of collapsing trade within former Yugoslavia, the government suspended the initiation of bankruptcy proceedings by the Social Accounting Agency (SDK) in the middle of 1991, thereby practically freezing the initiation of bankruptcies. The government not only relieved those firms from

---

<sup>19/</sup> The economic performance of the firms applying for financial assistance was typically below average, but many better-performing firms also applied. See "Work Report of Employment Office of Slovenia," various years.

<sup>20/</sup> Employment subsidies are applied to a stock of employment (subsidization of a worker during the entire time of employment); hiring subsidies are applied to flow into employment (subsidization of employment during the initial period of employment).

taxation and paying the electricity bills, but also granted them direct subsidies (some as cofinancing of training and early retirement). Employment subsidies represented 47 percent of expenses for labor market programs in 1991, compared with 14 percent spent on the true creation of jobs (similar proportions apply for 1992).<sup>21</sup> Total subsidies amounted to 12.1 billion toalars (5.6 billion in unpaid taxes, 3.8 billion for unpaid electricity, and 2.8 billion in direct subsidies), significant 3.5 percent of GDP.<sup>22</sup>

According to the Ministry of Planning, without the suspension, by August 1992 bankruptcy would have been initiated in 245 enterprises, affecting 99,700 workers, many of whom would have become unemployed. In addition, 219 enterprises, employing 60,000 workers, faced serious liquidity problems.

Public Employment Programs. A public employment program was initiated in 1991 to create special jobs for the unemployed (subject to the approval of the Republic Employment Office and in cooperation with local government).<sup>23</sup> The jobs were strictly of limited duration, with earnings comprising, besides unemployment

---

<sup>21/</sup> According to Bole (1992), the collapse of the Yugoslav market has caused Slovenian GDP to shrink only 6 percent, so its pressure on layoffs and unemployment has been limited.

<sup>22/</sup> Data for unpaid taxes and electricity -- Ministry of Planning (1992); data on direct subsidies -- Work Report of the Employment Office of Slovenia 1991.

<sup>23/</sup> The term public employment as used here encompasses not only public service employment, but also specially created jobs in other areas. (Public employment should, of course, be distinguished from social sector employment, which means employment in enterprises that are socially owned.)

compensation, a special bonus financed by the local government as an incentive for participation. Such programs were implemented in four areas: social protection (for example, providing child care and assistance to the elderly); education and culture; environmental clean-up; and municipal services.

Self-Employment Programs. In addition to a lump-sum payment of unemployment compensation, in 1991 the government also began to stimulate self-employment of the unemployed, through free advisory programs. The unemployed receive training on the organizational, legal, and financial aspects of beginning self-employment (such as preparing a business plan, registering their business, and getting access to credits and business space), as well as assistance in implementing specific ideas. A special advisory network has been organized by regional employment offices, drawing also on external expert groups. In 1991, more than 2,000 people were included in various advisory and training programs, and 200 new programs were launched.

Linked to the above are "enterprise incubator" programs, through which the government provides the professional and financial assistance needed to launch entrepreneurial projects. Incubators have operated mainly within large enterprises facing declining demand for their products. The task of incubators is to inspire and identify entrepreneurial ideas, and to offer advice and assistance in developing them, thereby replacing jobs in unprosperous lines of business with jobs in prosperous ones.

#### 4. PROBLEMS PLAGUING THE LABOR MARKET

Although the labor market has improved greatly in recent years, pressing problems still plague it. Workers are still overprotected, counterproductively encouraged to exit early from the labor market, and given generous fringe and cash benefits; collective bargaining is inefficient; the escalation of wages after the abolition of incomes policy threatens to fuel inflation; and some active labor market policies are hindering, rather than encouraging, the reallocation of labor.

##### (1) Inconsistent, Overrestrictive Redundancy Policy.

Although the Labor Code allows firms to lay workers off, it imposes heavy costs for doing so, which discourages layoffs.<sup>24</sup> For one thing, firms bear most of the burden of financing "technologically redundant" workers (training, purchasing pension credits, and providing up to six months of "paid vacation" and severance pay). Moreover, current legislation encourages costly rent-seeking. The legislation discriminates between firms in good financial standing (which can declare "technological redundancies") and those in poor financial standing (which produce "economic redundancies" by going through bankruptcy). Healthy firms, when laying off workers, bear a heavy burden, and external assistance is only optional. On the other hand, firms going through bankruptcy have no financial obligation for the workers they lay off. Such discrimination encourages firms in

---

<sup>24/</sup> Hiring is also affected. The cost of layoffs, by raising the cost of labor, reduces the demand for labor.

good standing to circumvent the law by initiating bankruptcy proceedings. But exploiting this loophole requires wasting real resources -- for example, in unnecessary administrative procedures -- and damages a firm's reputation. Moreover, the practice undermines good will and the system's general credibility.

The February 1991 legislation shortened the layoff procedure, but employers still face procedural hurdles in laying off workers. Not only does the rehabilitation program have to be submitted to employment offices, but flexible adjustment must survive any trade union objections and whatever arbitration ensues.

To prevent further growth of unemployment, the government has been encouraging early retirement by contributing up to 50 percent of the funds required to purchase the missing pension credits (early retirement started at age 50 for women, 55 for men). Many workers have opted to retire and leave the labor force. As a result, the ratio of employed workers to retirees has decreased from 2.6 in December 1989 to 2 in December 1991 (see table 1).

In the words of Mitchell (1992, p. 31), "retirement systems are not well-suited to solve unemployment problems." She advocates actuarially reduced benefits for early retirement, and gives the following arguments against generous early retirement programs:

- Decreased participation in the labor force, resulting

in the perpetuation of wage rigidities, and thus increased, not decreased, joblessness. (To which one can add that decreased participation in the labor force because of early retirement decreases the level of unemployment and hence its importance in disciplining workers).

- Failure to improve the demand for young workers (if the substitution between old and young workers is low, as seems to be the case).

- An increased fiscal burden on current and future workers, and thus reduced demand for labor.

Despite reduced demand for labor, few enterprises have shortened work hours or introduced other flexible job arrangements, such as job-sharing.

## **(2) Lack of Incomes Policy**

In line with falling production (GDP decreased by 2.6 percent in 1990 and an estimated 15 percent in 1991) the average real wage decreased 10.5 percent in 1990 and 12.4 percent in 1991 (Ministry of Planning 1992). But 1992 brought a dramatic reversal: although production is still falling, the average real wage increased 40 percent between February and August.

As the recent escalation of wages shows, the absence of an incomes policy -- while social ownership persists -- is likely to produce wage drift and thus fuel inflation. Under the present conditions (with pending privatization as an additional stimulus), firms have strong incentives to pay higher wages even if they default on other obligations (for example, payments for

inputs, taxes, and repayment of credits), thus creating inflationary pressures.

### **(3) Inefficient Collective Bargaining**

Collective bargaining and the agreements that result from it, suffer from a lack of trust among the principal agents, automatic cost-of-living adjustments, overly structured wages, and inappropriate representation of the parties involved in bargaining.

Lack of Trust and Cooperation. Despite signing agreements that resembled all-encompassing agreements, the major actors in collective bargaining -- trade unions, the Chamber of Economy, and the government -- have acted in an uncoordinated, sometimes hostile, way. For example, there was a two-hour general strike in March 1992, and there have been many other strikes lately. By signing the collective bargaining agreements, and then repudiating them through a more stringent Incomes Policy Law, the government contributed to the climate of mutual distrust. (The meager support of parliament weakened the government's bargaining position, which may have contributed to less fruitful bargaining.) There may be more frequent strikes, as well as uneven growth in wages across sectors, the subsequent catching up of those left behind, and a highly unstable macroeconomic environment, as a result.

Automatic Cost-of-Living Adjustment. The experience of other countries suggests that formally indexing wages leads to rapid wage adjustment to inflation (see, for example, OECD 1987).



Current bargaining agreements are bound to produce such a rapid wage adjustment and thus rule out the real wage moderation that may be necessary for successful reform. Automatic cost-of-living adjustments also make it impossible to adjust the current wage structure, thus hindering the mobility of labor.

Overstructuring of Wages. Slovenia's collective bargaining contracts determine not only the minimum wage, but the minimum level of pay for each worker -- the wage scale. But the administrative setting of wages decreases efficiency in at least five ways. (A) A wage scale produces misallocation of labor. It only takes into account (and only in a limited sense) the demand for labor; it ignores the supply of labor. More workers will be unemployed because the firms' demand for labor is administratively constrained -- a classical objection against the minimum wage legislation. (B) The wage scale is likely to accentuate the pay equalization effect of unions, thus hindering inter-enterprise mobility of labor.<sup>25</sup> (C) As experience in the Scandinavian countries shows, a compressed wage structure also fuels inflation (OECD 1987). (D) The wage scale precludes adjustment through voluntary wage cuts, and may force some firms into bankruptcy. (E) Administrative wage scales may limit a firm's ability to encourage long-term employment by offering lower pay in the first years of employment and "overcompensating"

---

<sup>25</sup>/ To maintain the support of their members, unions contribute to pay equalization (see Freeman and Medoff 1984). The same tendency of wage equalization was produced under self-management (on the effects of democratic determination of wages under self-management, see Vodopivec 1992).

workers who stay with the firm a long time. In short, the proposed administratively determined minimum wage structure only appears to protect workers. In a sense, it reintroduces the old-style wage determination through the back door, with the same old effect of misallocating labor.

Inappropriate Representation in Bargaining. At the heart of the issue is the problem of ownership. The employers' interests are represented by the Chamber of Economy. But the Chamber is an association of social enterprises, not an association of owners, so its interests are not identical with those of private owners. The interests of the Chamber coincide much more with those of the government, which are broader than strict profit maximization. The workers' side, at present, is also misrepresented. The "old," official trade unions are increasingly challenged by the newly emerging unions, and the final balance of power -- and its representation at the bargaining table -- has not yet been determined.

#### (4) Overgenerous Benefits

Judging from experience in the OECD countries, current unemployment compensation is too generous in terms of both the replacement ratio and the length of time an entitlement is effective (see, for example, Barr 1990). This not only creates undue fiscal pressures; it also perversely affects incentives for reemployment.

•

Moreover, the present pay system offers fringe benefits not typically found in a market economy (such as free meals,

transportation to and from work, subsidized housing, and paid and unpaid special leave). These extra benefits introduce inefficiency into the wage setting. Firms prefer such in-kind payments over cash because many of them are included in a firm's costs and are thus tax-free. Once the tax status of in-kind and cash earnings is equalized, workers are likely to prefer the cash. Many of these in-kind benefits are relics of the past that should be discouraged, if the goal is to provide undistorted incentives for labor reallocation.

**(5) Lack of Coherent Active Labor Market Policies**

Some active labor market programs appear to be promising (among them, public employment programs and hiring subsidies, if the latter is buttressed by a sensible retention requirement). Others need to be corrected or abolished.

Probably the most damaging -- and costly -- are employment subsidies. By granting employment subsidies and suspending bankruptcies to preserve jobs and social peace, the government resumed the paternalistic, redistributive role that it played for decades (see Kraft and Vodopivec 1992). Although politically expedient, such a policy is extremely damaging. OECD (1987, p. 237) ranks the marriage of social and industrial policies as first on the list of industrial policies that failed.<sup>26</sup> Moreover, the program diverts resources earmarked for active labor market policies and suffers from weak control (for example,

---

<sup>26/</sup> Vodopivec (1992b) attributes the failure of Yugoslavia's system to the pervasive and massive policies of interfirm redistribution -- that is, to state paternalism.

for whether the funds are really spent for the purpose approved). Most of the enterprises receiving employment subsidies repeatedly knock at the government door.

The effectiveness of various training programs needs more thorough evaluation than can be provided here. Let us just briefly mention one possible shortcoming of the internship program -- the lack of retention requirement. Since introduced in 1989, financing of interns by the Employment Offices has, no doubt, stimulated the employment of interns. But since interns are externally financed, firms have strong incentives to hire a new intern to replace the one whose internship has ended. (Indeed, most interns have been refused permanent employment when their internship ends, Work Report of the Employment Office of Slovenia 1990).

## 5. LESSONS LEARNED

Slovenian labor market policies have confronted the major problems of the economic transition, but not always wholeheartedly or in the most efficient way. To evaluate current labor market policies and practices requires in-depth research, but some lessons -- particularly relevant for other economies in transition -- are clear.<sup>27</sup>

Reallocate Labor by the Creation of New Jobs, Not the Preservation of Old. As Slovenian experience shows, governments

---

<sup>27/</sup> A thorough study of the determinants of labor market transitions in Slovenia is under way (Abraham and Vodopivec 1991).

in transitional economies tend to preserve current jobs through employment subsidies, and to subsidize early retirement. To stimulate the efficient reallocation of labor, they should redirect resources into job creation programs -- to keep the employment preservation programs in check, exposing them to wide public scrutiny may help. Without relevant experience from other countries to go by, the trial and error approach to finding the right mix of active labor market policies is unavoidable.<sup>28</sup> But governments should evaluate the effectiveness of such programs, and weigh them against alternative policies aimed at reducing unemployment -- notably increased public spending and investment tax credits (see Palmer 1978).

Moreover, to increase the flexibility of adjusting firms' workforces, transitional economies should legislate simple layoff procedures, and should not assign firms the responsibility for financing redundant workers.

Retain Incomes Policy and Rationalize Wage Setting. The Slovenian experience shows that while it may be easy to demolish the old system of wage determination, it is difficult to build a new, well-functioning system, particularly during the transition. One important lesson learned is the necessity -- while state and social ownership prevail -- of curbing pay increases to prevent wage drift. Tax-based incomes policy, with taxes imposed on the

---

<sup>28/</sup> Particular attention might be paid to job search assistance, shown to be the most efficient assistance to displaced workers in developed economies (Leigh 1989).

wage bill to stimulate labor cuts, may be a solution.<sup>29</sup> In the long run, however, small, open, highly unionized economies should try to steer collective bargaining in the direction of all-encompassing bargaining, thus making incomes policies unnecessary.<sup>30</sup>

In setting up a wage determination system, no country should copy faithfully the experience of other countries. Although some successful economies (Germany, for example) determine wage structures by establishing a floor on wages for different categories of workers, doing so in transitional economies is likely to be counterproductive.<sup>31</sup> There, the only price of labor that should be fixed is the minimum wage. This will allow collective bargaining to achieve wage moderation, to produce a flexible wage structure and thus to facilitate the reallocation of labor -- which is particularly desirable in the current transition. Automatic cost-of-living adjustments, which hinder wage moderation and make the wage structure inflexible, should also be avoided.

---

<sup>29/</sup> Social ownership not only encourages wage drift, but also jeopardizes the effectiveness of a tax-based incomes policy. If a firm can "borrow" to pay excess wages, it may be in a position to borrow even more to pay excess wages and taxes imposed on wage increases. In such circumstances, agreeing to general wage increases through encompassing bargaining could be a more desirable solution even in the short run -- but, unfortunately, such a solution is often not a feasible one.

<sup>30/</sup> Such a system is practiced, for example, in Austria, Germany, Norway and Sweden, where widespread coverage and highly centralized bargaining allow the benefits of wage moderation to be shared by all participants in collective bargaining (Layard 1990).

<sup>31/</sup> Another example of interference in wage setting is provided by Armenia, which has recently contemplated recommending the wage scale of civil servants to the rest of the economy.

Build Support for Reform. Unilateral action by the Slovenian government -- implicitly relying on inaction by the part of the trade unions -- has been counterproductive: it is both inadequate and unsustainable. To overcome mutual hostility and achieve cooperation, governments in transitional economies should, among other things, consult with trade unions on the legislation and programs to be introduced. This is particularly important for containing wage drift.

To maintain support for market-oriented reform, the government should wage a continuous public relations campaign to demonstrate the unavoidability of the reforms (as the price to be paid for the long-lasting wrong policies of the past), and the government's commitment to facilitate the needed adjustment by encouraging the efficient reallocation of labor and by spreading costs equitably among different segments of the population. To counterbalance perceived negative developments (such as the growth of unemployment), the government should emphasize successes (such as people getting regular employment after finishing training or public employment programs) --Hirschman's "tunnel" effect.

## REFERENCES

- Abraham, Katharine and Vodopivec, Milan (1991). "Labor Market Dynamics During the Transition of a Socialist Economy." World Bank: Research Proposal, processed.
- Barr, Nicholas (1990). Economic Theory and the Welfare State: A Survey and Reinterpretation. London School of Economics and Political Science, processed.
- Bole, Veljko (1992). "Slovenian Economy in General Disequilibrium," Gospodarska gibanja, No. 230, August 1992.
- Employment Office of Slovenia. Work Report (various years), processed.
- Freeman, Richard B. and Medoff, James L. (1984). What Do Unions Do? New York, NY: Basic Books, Inc.
- Korze, Uros (1991). Decentralized Privatization Strategy -- Slovenia. In Privatization in Central and Eastern Europe, Ljubljana: International Center for Public Enterprises.
- Kraft, Evan and Vodopivec, Milan (1992). "How Soft is the Budget Constraint for Yugoslav Firms?" (with E. Kraft), Journal of Comparative Economics, 16:3, 1992, pp. 432-455.
- Lane, Timothy D. (1991). "Wage Controls in Reforming Socialist Economies: Design, Coverage, and Enforcement", in Coricelli, Fabrizio, and Revenga, Ana, Eds., Wage Policy During the Transition to a Market Economy: Poland 190-91, World Bank, processed.
- Layard, Richard (1990). "Wage Bargaining, Incomes Policy and Inflation: Possible Lessons for Eastern Europe." World Bank Seminar on Managing Inflation in Socialist Economies, Vienna March 1990.
- Leigh, Duane E. (1989). Assisting Displaced Workers: Do the States have a Better Idea?, Kalamazoo, MI: Upjohn Institute for Employment Research.
- Mencinger, Joze (1989). "Economic Reform and Unemployment." Privredna kretanja Jugoslavije 19: March 1989, 23-38.
- Ministry of Planning (1992). Slovenia in 1991-1992. Report on Economic Developments, June 1992.
- Mitchell, Olivia S. (1992). Retirement Systems in the OECD: Institutional Features, Economic Effects, and Lessons for Economies in Transition. School of Industrial and Labor Relations, Cornell University, processed.
- OECD (1987). Structural Adjustment and Economic Performance. Paris: OECD.
- Palmer, John L. (1978). Creating Jobs: Public Employment Programs and Wage Subsidies. Institute for Research on Poverty and the Brookings Studies in Social Economics, Brookings Institution.
- Prasnikar, Janez, Jan Svejnar, Dubravko Mihaljek, and Vesna Prasnikar (1990). A Test of Enterprise Behavior Under Labor-Management, University of Pittsburgh, processed.
- Prasnikar, Janez and Jan Svejnar (1988). "Economic Behavior of Yugoslav Enterprises," Advances in the Economic Analysis of Participatory and



Labor-Managed Firms, 3: 237-311.

Renaud, Bertrand (1990). Housing Reforms in Socialist Countries. World Bank.

Rus, Veljko (1992). The Slovenian Labor Market. Ljubljana, Institute for Social Sciences, processed.

Svetlik, Ivan (1992). Changing Labour Market and Employment Policies. Ljubljana, Institute for Social Sciences, processed.

Vodopivec, Milan (1992a). The Effects of Democratic Determination of Wages: Theory and Evidence from Self-Managed Firms, World Bank, PR Working Paper No, 971.

Vodopivec, Milan (1992b). "State Paternalism and the Yugoslav Failure," in A. Hillman and B. Milanovic, eds., The Transition from Socialism in Eastern Europe: Domestic Restructuring and Foreign Trade, Washington, DC: The World Bank, 1992, pp. 159-178. (E)

Vodopivec, Milan (1991a). "The Labor Market and the Transition of Socialist Economies," Comparative Economic Studies, 33:2, pp. 123-158.

Vodopivec, Milan (1991b). "The Persistence of Job Security in Reforming Socialist Economies," Soviet Studies, 43:6, pp. 1011-1025.

# Policy Research Working Paper Series

Title	Author	Date	Contact for paper
WPS1137 Railway Reform in the Central and Eastern European Economies	Phillip W. Blackshaw Louis S. Thompson	May 1993	TWJTD 31005
WPS1138 The Economic Impact of Military Expenditures	Daniel Landau	May 1993	C. Jones 37699
WPS1139 Should Sub-Saharan Africa Expand Cotton Exports?	Jonathan R. Coleman M. Elton Thigpen	May 1993	G. Ilogon 33732
WPS1140 How Retail Food Markets Responded to Price Liberalization in Russia after January 1992	Bruce Gardner Karen M. Brooks	May 1993	C. Spooner 32116
WPS1141 Foreign Direct Investment in a Macroeconomic Framework: Finance, Efficiency, Incentives, and Distortions	Maxwell J. Fry	May 1993	R. Vo 31047
WPS1142 Rent-Seeking Trade Policy: A Time-Series Approach	Martin Rama	May 1993	D. Ballantyne 37947
WPS1143 Tariff Rates, Tariff Revenue, and Tariff Reform: Some New Facts	Lant Pritchett Geeta Sethi	May 1993	M. Fernandez 33766
WPS1144 The Foreign Trade Dimension of the Market Transition in Poland: The Surprising Export Performance and Its Sustainability	Bartłomiej Kaminski	June 1993	P. Kokila 33716
WPS1145 The Simple(r) Algebra of Pension Plans	Dimitri Vitas	June 1993	P. Infante 37664
WPS1146 Is Poverty Increasing in the Developing World?	Shaohua Chen Gaurav Datt Martin Ravallion	June 1993	P. Cook 33902
WPS1147 Interest Rates, Growth, and External Debt: The Macroeconomic Impact of Mexico's Brady Deal	Stijn Claessens Daniel Oks Sweder van Wijnbergen	June 1993	R. Vo 33722
WPS1148 Economic Instability and Aggregate Investment	Robert S. Pindyck Andrés Solimano	June 1993	S. Moussa 39019
WPS1149 How Labor Markets and Imperfect Competition Affect Tariff Policy	Martin Rama	June 1993	D. Ballantyne 37947
WPS1150 Wealthier is Healthier	Lant Pritchett Lawrence H. Summers	June 1993	WDR 31393

# Policy Research Working Paper Series

	<b>Title</b>	<b>Author</b>	<b>Date</b>	<b>Contact for paper</b>
WPS1151	Is Growth Bad for the Environment? Pollution, Abatement, and Endogenous Growth	Charles van Marrewijk Federick van der Ploeg Jos Verbeek	July 1993	J. Verbeek 33935
WPS1152	Population, Health, and Nutrition: Annual Operational Review for Fiscal 1992	Denise Vaillancourt Stacye Brown and Others	July 1993	O. Nadora 31091
WPS1153	North American Free Trade Agreement: Issues on Trade in Financial Services for Mexico	Alberto Musalem Dimitri Vittas Asli Demirgüç-Kunt	July 1993	P. Infante 37664
WPS1154	Options for Pension Reform in Tunisia	Dimitri Vittas	July 1993	P. Infante 37664
WPS1155	The Regulation and Structure of Nonlife Insurance in the United States	Martin F. Grace Michael M. Barth	July 1993	P. Infante 37664
WPS1156	Tropical Timber Trade Policies: What Impact Will Eco-Labeling Have?	Panayotis N. Varangis Carlos A. Primo Braga Kenji Takeuchi	July 1993	D. Gustafson 33714
WPS1157	Intertemporal and Interspatial Comparisons of Income: The Meaning of Relative Prices	Sultan Ahmad	July 1993	E. O'Reilly- Campbell 33707
WPS1158	Population Growth, Externalities, and Poverty	Nancy Birdsall Charles Griffin	July 1993	E. Hornsby 35742
WPS1159	Stock Market Development and Financial Intermediary Growth: A Research Agenda	Asli Demirgüç-Kunt Ross Levine	July 1993	P. Sintim- Aboagye 38526
WPS1160	Equity and Bond Flows to Asia and Latin America: The Role of Global and Country Factors	Punam Chuhan Stijn Claessens Nlandu Mamingi	July 1993	Rose Vo 31047
WPS1161	Increasing Women's Participation in the Primary School Teaching Force and Teacher Training in Nepal	Molly Maguire Teas	July 1993	L. Maningas 80380
WPS1162	The Slovenian Labor Market in Transition: Issues and Lessons Learned	Milan Vodopivec Samo Hribar-Milic	July 1993	S. Moussa 39019